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Effective due diligence considers human rights risk

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Compliance has traditionally been associated with anti-corruption, bribery, and transparency risks in the corporate setting, not with human rights risk as part of due diligence processes. However, recent regulatory trends show a strong movement toward mandatory human rights compliance. Business organizations should take notice of this since it has direct implications for how businesses will have to retool their compliance programs if they want to make their operations viable and profitable as part of responsible business practices.

The rising standard

Just this past April, the European Union's Commission announced its commitment to introduce rules for mandatory human rights due diligence that will have direct implications for those companies with operations in member countries.[1] The United States–Mexico–Canada Agreement[2] trade deal, which entered into force this past July, established a new set of provisions regarding the use of forced labor and child labor that requires companies in the three signatory countries (Canada, Mexico, and the United States) to establish effective due diligence measures to avoid enforcement action.[3]

Governments or regional blocks do not only lead this trend. Global investors are paving the way through a growing demand for public disclosures of the human rights impacts created by the companies they invest in and transparency of the mitigation and remediation efforts they put in place throughout their business cycle. And all of this is happening in the midst of an unprecedented global pandemic affecting every corner of the world and where the private sector is certainly confronting existential threats to business models.

Responsible investors are already building momentum worldwide through shareholder advocacy efforts and compliance requirements to secure a sustainable impact investment. As of 2020, the Investor Alliance for Human Rights[4] has been able to mobilize more than $5 trillion in assets under management to lead shareholder engagement initiatives and dialogue to facilitate disclosures and transparency from boards of directors and upper management for human rights impacts and grievances. And when these engagements fail, some investors do not stop there. Confronted with concerning reputational impacts, investors also move toward divestment. This was the case for Norges Bank[5] when, earlier this year, it announced its decision to exclude 12 companies from Norway's $1 trillion pension fund due to human rights and environmental concerns.

Assessments and disclosure demands also apply to clients and companies across industries seeking access to international project finance and debt markets. The Equator Principles Association (EPA) includes 109 members (private financial institutions) in 38 countries that have officially adopted the Equator Principles as the financial industry benchmark for determining, assessing, and managing environmental and social risks in project finance and debt markets. EPA members commit to implement the principles themselves and to not provide project finance or project-related corporate loans to projects in developed and emerging markets where the client will not or is unable to comply with the principles.[6]

What do all these efforts mean in practice for companies and business organizations? The message coming from government regulation efforts, investors, and financial institutions is clear: If business organizations (whether parent or subsidiaries) and those seeking access to international project financing avoid human rights compliance, they will confront legal, reputational, and operational risks negatively affecting their financial bottom line, viability, and access to capital. Global investors are beginning to seek sustainable impact investments while conditioning them to a company's commitment to a human rights risk due diligence strategy.